

**CALIFORNIA BOARD OF ACCOUNTANCY**

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**INITIAL STATEMENT OF REASONS**

**Hearing Date:** July 25, 2003

**Subject Matter of Proposed Regulations:** Experience Requirements for Licensure, Continuing Education.

**Amend Section 12 of Title 16 of the California Code of Regulations.**

**Specific Purpose:**

This proposal adds a definition of what it means to supervise an applicant's experience pursuant to Business and Professions Code Section 5092 or 5093. It also adds a provision indicating that the CPA providing services to the applicant's private industry employer, government agency employer, or other non-public accounting employer cannot verify the applicant's experience. This proposal would also reorganize some of the provisions of subsection (a) of Section 12 into numbered paragraphs.

**Factual Basis/Rationale:**

When the Legislature enacted Sections 5092 and 5093 in 2001 and the Board adopted Section 12 as an implementing regulation, it was intended that an applicant employed in private industry or government would have his or her experience verified by an employee of the applicant's company or agency who had a regular supervisory relationship with the applicant. However, there has been confusion regarding who may supervise an applicant's general experience pursuant to Business and Professions Code Section 5092 or 5093, and some applications for licensure have been received in which the applicant's experience has been verified by the CPA who audited the applicant's private industry employer (external auditor). Current Section 12 does not expressly prohibit this. Revisions are needed to clarify requirements and to make Section 12 more consistent with legislative intent by prohibiting the verification of experience by the external auditor.

There is also confusion regarding the meaning of "supervision." Applicants and licensees have inquired whether supervision can be provided by a CPA who does not directly oversee the applicant's work. Adoption of a definition of supervision is necessary to enhance clarity by indicating that supervision involves direct oversight and personal, ongoing communication between the supervisor and the applicant regarding the applicant's professional accounting work.

## **Amend Section 12.5 of Title 16, of the California Code of Regulations.**

### **Specific Purpose:**

This proposal adds a definition of what it means to supervise an applicant's experience pursuant to Business and Professions Code Section 5095. It also adds a provision indicating that the CPA providing services to the applicant's private industry employer, government agency employer, or other non-public accounting employer cannot verify the applicant's experience. This proposal would also reorganize some of the provisions of subsection (c) of Section 12.5 into numbered paragraphs.

### **Factual Basis/Rationale:**

There has been confusion regarding who may supervise an applicant's audit and review experience (attest experience) pursuant to Business and Professions Code Section 5095. To achieve consistency with the proposed revisions to Section 12 and to ensure that applicants gain the appropriate experience applying professional standards related to audits and reviews, the Board concluded that experience may not be supervised by a licensee who provides public accounting services to the applicant's non-public accounting employer. Also, to achieve consistency, the same definition of supervision should be in both Section 12 and Section 12.5. (See the "Factual Basis" for Section 12 for more information.)

## **Amend Section 87 of Title 16 of the California Code of Regulations.**

### **Specific Purpose:**

This proposal would add new subsection (d) to Section 87 to mandate eight hours of continuing education in detecting fraud affecting financial statements or reporting on financial statements during each two-year renewal cycle. This continuing education would be part of the 80 hours of continuing education currently required for license renewal. New subsection (d) would apply to licensees renewing their licenses after July 1, 2004, who must complete continuing education in accounting and auditing or in government auditing. This proposal also re-letters other provisions of Section 87 for consistency with this new requirement.

### **Factual Basis/Rationale:**

In recent years investors have suffered significant losses as a result of fraudulent conduct by corporate management. To address this crisis in investor confidence and to enhance auditors' ability to detect fraud, this proposal would add a requirement of eight hours of continuing education in fraud detection.

This requirement would apply to licensees who are required to complete continuing education in accounting and auditing and/or government auditing since these are the licensees who perform the critical audit and review work.

Eight hours is specified because most continuing education courses are eight hours in length. Further, if more hours were mandated, it could be difficult for licensees to complete all of the other courses they might need to maintain competency.

The July 1, 2004, start date was selected to give licensees sufficient opportunity to schedule and complete the required class(es).

### **Amend Section 87.1 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

Section 87.1 specifies requirements for licensees converting to active status prior to renewal. This proposal would add a new subsection (d) to Section 87.1 to require eight hours of continuing education in detecting fraud affecting financial statements or reporting on financial statements. New subsection (d) would apply to those licensees converting to active status after July 1, 2004, who must complete continuing education in accounting and auditing or in government auditing. This proposal also re-letters other provisions of Section 87.1 for consistency with this new requirement.

#### **Factual Basis/Rationale:**

This revision is necessary so that the continuing education requirements for conversion of the license to active status are essentially the same as the requirements for renewing the license in active status. See the "Factual Basis" for the amendment of Section 87 for an explanation of the necessity for a fraud detection continuing education requirement.

### **Amend Section 90 of Title 16 of the California Code of Regulations.**

#### **Specific Purpose:**

Current Section 90 permits licensees who become subject to the government auditing continuing education requirement in subsection (b) of Section 87 or the accounting and auditing continuing education requirement in subsection (c) of Section 87 during the last six months of a two-year license renewal period to be granted, upon request, an extension of time of up to six months in which to complete the required continuing education. This proposal would make the same extension provision applicable to the fraud detection continuing education requirement proposed in new subsection (d) of Section 87.

#### **Factual Basis/Rationale:**

This revision is necessary to make the requirements for fraud detection continuing education consistent with the requirements for governmental auditing and accounting and auditing continuing education. The extension is granted so that the requirement is not burdensome to licensees, and licensees are not penalized merely because they

become subject to the requirement too late in the renewal cycle to complete an appropriate course.

THE FOLLOWING APPLY TO THE PROPOSAL AS A WHOLE:

**Underlying Data:** None.

**Business Impact:**

These regulations will not have a significant adverse economic impact on businesses. This initial determination is based on the following facts or evidence/documents/testimony:

The proposed amendments to Section 12 and 12.5 place no requirements on businesses, but apply specifically to the supervision of applicants for licensure. With regard to the proposed amendments related to continuing education, this proposal will not affect the overall cost of continuing education for licensees since there will be no change in the total number of continuing education hours that must be completed for license renewal.

**Specific Technologists or Equipment:**

These regulations do not mandate the use of specific technologies or equipment.

**Consideration of Alternatives:**

No reasonable alternative to these regulations would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected:

With regard to supervision, the Board's Qualifications Committee proposed allowing attest experience to be gained in private industry under the supervision of the external auditor, provided the employee was "temporally transferred" to the external auditor. The applicants' work papers could then be reviewed by the Board's Qualifications Committee. This alternative was rejected because the term "temporally transferred" lacked clarity. Also it was concluded that applicants and licensees might be confused if the requirements for the supervision in Section 12.5 were different from the requirements for supervision in Section 12.

With regard to the fraud detection continuing education requirement, the Board's Committee on Professional Conduct (CPC) considered recommending that fraud detection continuing education be part of the 24-hour accounting and auditing continuing education requirement. This option was rejected because it was concluded that 24 hours of accounting and auditing continuing education was critical, and therefore eight hours of fraud continuing education should be required in addition to the accounting and auditing continuing education requirement.